

Internal Revenue Service
NO PROTEST RECEIVED
Release copies to District

Date

6/7/99 6/7/99

Surname

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Department of the Treasury

Washington, DC 20224

Contact Person:

[REDACTED]

Telephone Number:

[REDACTED]

In Reference to:

OP:E:EO:T:1

Date:

APR 26 1999

Employer Identification Number

Key District:

[REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(4). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

FACTS

You were organized on [REDACTED] under the state laws of [REDACTED]. Your Articles of Incorporation provide that you are organized and operated to: 1) form and operate a regional, integrated health care delivery system; 2) serve local communities by coordinating and collectively providing, primarily through the Corporation's members, high quality, cost effective services that meet the needs of patients and purchasers of health care; and 3) assist, in connection with the regional, integrated health care delivery system, the conduct of health care quality and outcomes research and health education.

You were organized by seven section 501(c)(3) non-profit hospitals. Currently, your members include: [REDACTED], [REDACTED], [REDACTED], [REDACTED], [REDACTED], [REDACTED], and [REDACTED] (collectively known as "Members").

In your Form 1024, you indicated that your social welfare purposes include performing certain PHO functions, or coordinating and centralizing the functions of existing non-profit PHOs at member hospitals. Such activities will necessitate physician involvement. Furthermore, you stated that one of your purposes could include the development and negotiation of service agreements among institutional, medical and other health care providers.

You anticipate that your primary source of financial revenue will be derived from administrative receipts if a beneficial capitated plan is established. However, eventually you will

receive contract administrative fees.

In an information letter dated [REDACTED], we asked you to provide additional information concerning your operations. In your response letter dated [REDACTED], you described yourself as a "super PHO." That is, you will negotiate purchasing contracts for your Members. Specifically, you ask each member, and its associated network, to specify what price or fee schedule it would be willing to accept in order to engage in provider contracts with payors. Such payors will include ERISA plans, government health care plans, or potentially, national networks such as [REDACTED]. If the payor agrees to the schedules provided independently by the hospital networks, then it can sign up and obtain access to the combined physician-hospital networks. The individual hospital networks will not act together in order to determine the pricing, but this is done in order to prevent any violation of antitrust rules and does not indicate that hospitals are not closely involved with or controlled by your organization.

In your response letter dated [REDACTED], you addressed three areas: 1) potential PHO activities, 2) developing and managing a health database, and 3) relationships with [REDACTED]. In response to our questions regarding your PHO activities, you stated that you are still in the process of formulating your potential PHO and database functions; however, you are considering forming a classic PPO (preferred provider organization). In response to our question regarding your relationship with your landlord, [REDACTED], you stated that because your Members employ so many employees, you have no means of determining who has a direct or indirect interest in [REDACTED].

In your letter dated [REDACTED], you stated that you are not established as a capitated HMO, although this alternative remains open for the future. Moreover, you are probably not a risk-bearing PPO; however, you will serve as a contracting agent, and in some degree as a PHO, for your Members.

You stated that you have [REDACTED] hospital members, [REDACTED] nonprofit and [REDACTED] for-profit. Such Members will not necessarily act in concert with respect to contract pricing, but they will work very closely with and control you.

LAW

Section 501(c)(4) of the Internal Revenue Code grants exemption to civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

Section 1.501(c)(4)-1(a)(1) of the Regulations provides that a civic league or organization may be exempt as an organization described in section 501(c)(4) if it is not organized or operated for profit and it is operated exclusively for the promotion of social welfare (Emphasis added).

Section 1.501(c)(4)-1(a)(2)(i) of the Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Section 1.501(c)(4)-1(a)(2)(ii) of the Regulations provides that an organization is not operated primarily for the promotion of social welfare if it is carrying on business with the general public in a manner similar to organizations operated for profit.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable, scientific or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and includes the promotion of social welfare by organizations which are organized and operated in conformity to the requirements of section 501(c)(3) of the Code. An organization may, therefore, be exempt as a social welfare organization under either section 501(c)(3) or 501(c)(4), depending upon how it is organized and what restrictions are placed on its activities. See section 1.501(c)(4)-1(a)(2)(i) of the Regulations. Accordingly, precedents under either code section are relevant in determining whether an organization is engaged in the promotion of social welfare. Similarly, ordinary commercial operations will not support exemption under either section of the Code.

Rev. Proc. 90-27, 1990-1 C.B. 514, sec. 5.01 provides that a determination letter will be issued to an organization provided its application and supporting documents establish that it meets the particular requirements of the section under which exemption is claimed. Furthermore, sec. 5.02 provides that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures or other means adopted or planned for carrying out the activities, the anticipated source of receipts, and the nature of

contemplated expenditures. In such cases where an organization is unable to describe fully its purposes and activities, a refusal to issue a ruling or determination letter will be considered an initial adverse determination from which administrative appeal or protest rights will be afforded.

Rev. Rul. 86-98, 1986-2 C.B. 74, involved an individual practice association (IPA) of private practice physicians whose purpose was to arrange for the delivery of health services through contracts negotiated with health maintenance organizations (HMOs). The IPA's primary activities were to serve as a bargaining agent for its members in dealing with HMOs and to perform the administrative claims services required by the agreements negotiated with the HMOs. The Service found that the IPA did not provide to HMO patients access to medical care which would not have been available but for the establishment of the IPA, nor did it provide such care below reasonable and customary fees. Because the IPA operated in a manner similar to organizations carried on for profit and its primary beneficiaries were its member-physicians rather than the community as a whole, the Service denied the IPA exemption under sections 501(c)(4) and 501(c)(6) of the Code.

Rev. Rul. 77-3, 1977-1 C.B. 140, a nonprofit organization that provides rental housing and related services at cost to a city for its use as free temporary housing for families whose homes have been destroyed by fire is not an exempt charitable organization. This revenue ruling states:

[I]t is the city rather than the organization that is providing free temporary housing to the distressed families. The organization is merely leasing housing property and providing certain maintenance and other services in connection therewith to the city at cost in a manner similar to organizations operated for profit, and is not itself engaged in charitable activities.

Rev. Rul. 73-349, 1973-2 C.B. 179, held that an organization formed to purchase groceries for its members, at the lowest possible prices, on a cooperative basis is not exempt as a social welfare organization within the meaning of section 501(c)(4) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, describes an organization formed to provide management and consulting services at cost to unrelated exempt organizations. This revenue ruling states:

Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that these services in this case are provided at cost and solely for

exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 70-535, 1970-2 C.B. 117, describes an organization formed to provide management, development and consulting services for low and moderate income housing projects for a fee. The revenue ruling held that the organization did not qualify under section 501(c)(4) of the Code. The revenue ruling stated:

Since the organization's primary activity is carrying on a business by managing low and moderate income housing projects in a manner similar to organizations operated for profit, the organization is not operated primarily for the promotion of social welfare. The fact that these services are being performed for tax-exempt corporations does not change the business nature of the activity.

Rev. Rul. 69-528, 1969-2 C.B. 127, describes an organization formed to provide investment services on a fee basis only to organizations exempt under section 501(c)(3) of the Code. The organization invested funds received from participating tax-exempt organizations. The service organization was free from the control of the participating organizations and had absolute and uncontrolled discretion over investment policies. The ruling held that the service organization did not qualify under section 501(c)(3) of the Code and stated that providing investment services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

Rev. Rul. 54-305, 1954-2 C.B. 127, describes an organization whose primary purpose is the operation and maintenance of a purchasing agency for the benefit of its otherwise unrelated members who are exempt as charitable organizations. The ruling held that the organization did not qualify under section 101(6) of the Code (the predecessor to section 501(c)(3)) because its activities consisted primarily of the purchasing of supplies and performing other related services. The ruling stated that such activities in themselves cannot be termed charitable but are ordinary business activities.

In the case of N.Y. State Assn. Of Real Est. Bds. Group Ins. Fund v. Comm., 54 T.C., 1325 (1970) insurance was offered exclusively to a limited class of members and their employees. Since the fund was organized for the benefit of its members only, the court held that it did not qualify under section 501(c)(4) of the Code.

In Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978), a

[REDACTED]

nonprofit corporation that assisted charitable organizations in their fund raising activities by providing financial planning advice on charitable giving and tax planning to wealthy individuals was held not to qualify under section 501(c)(3) of the Code because its tax planning services were a substantial nonexempt activity enabling the corporation to provide commercially available services to wealthy individuals free of charge.

Living Faith, Inc. v. Commissioner, 950 F.2d. 365 (7th Cir. 1991), involved an organization that operated restaurants and health food stores with the intention of furthering the religious work of the Seventh-Day Adventist Church as a health ministry. However, the Seventh Circuit held that these activities were primarily carried on for the purpose of conducting a commercial business enterprise. Therefore, the organization did not qualify for recognition of exemption under section 501(c)(3) of the Code.

RATIONALE

1. Insufficient Description of Activities

In order for the Service to recognize a section 501(c)(4) exemption, the organization must describe its activities in sufficient detail to support a conclusion that it is exempt under that Code section. Rev. Proc. 90-27, *supra*. In your responses, you have failed to adequately describe your activities in order to support such a conclusion.

On **[REDACTED]**, we mailed you an information letter requesting extensive information about your activities. The focus of the information letter was threefold: 1) your PHO activities; 2) your data base activities; and 3) your relationship with your landlord, **[REDACTED]**. You stated you are in the process of establishing your PHO and data base activities. In addition, you stated that because of the myriad of Member employees, you have no means of determining if any direct or indirect relationships exist between you and **[REDACTED]**.

Your responses to our questions were vague and conjectural. Hence, because you have failed to sufficiently describe your operations, you have also failed to provide an evidentiary basis that would support a favorable ruling on your section 501(c)(4) exempt status. Rev. Proc. 90-27, *supra*.

2. Section 501(c)(4) Exemption

On **[REDACTED]**, you requested that we render a decision based on the information you submitted. Not only is that information insufficient to support a favorable ruling on your section

501(c)(4) status, it affirmatively demonstrates that you are not entitled to exemption under that section.

In order to satisfy the requirements of section 501(c)(4), you must be operated for the promotion of social welfare and must further the common good and general welfare of the people of the community rather than being engaged in activities of an ordinary commercial nature. See sections 1.501(c)(4)-1(a)(2)(i) and (ii) of the Regulations, *supra*.

Based on the information submitted, you are essentially serving as a broker or negotiator between your Members and their Payors. Each Member informs you of an acceptable purchasing contract price, and the Payor determines whether such purchasing contract price is acceptable. If the Payor accepts the purchasing contract price, then you inform the Member and a contract is consummated.

These activities do not further the common good and general welfare of the people of the community. They are merely a commercial service provided for the benefit of your Members and their clients. You are thus similar to the organizations described in Rev. Ruls. 86-98, 77-3, 73-349, 69-528, 54-305, N.Y. State Assn. Of Real Est. Bds. Group Ins. Fund. Christian Stewardship Assn., and Living Faith, *supra*. Therefore, you are not entitled to exemption under section 501(c)(4).

CONCLUSION

For the reasons stated above, you do not qualify for exemption under section 501(c)(4) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key district office. Thereafter, any questions about your federal income tax status should be addressed to that office.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

**Internal Revenue Service
Attn: CP:E:EO:T:1; Room 6142
1111 Constitution Ave, N.W.
Washington, D.C. 20224**

If you wish to FAX any information to us, our FAX number is [REDACTED]. If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Marvin Friedlander

**Marvin Friedlander
Chief, Exempt Organizations
Technical Branch I**